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IN THE
Supreme Court of the United States
OCTOBER TERM, 1978

NO. 77-648

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner
v.
PENNZOIL PRODUCING COMPANY, *ET AL.*
Respondents

On Writ of Certiorari to the United States
Court of Appeals For the Fifth Circuit

**BRIEF OF RESPONDENT
UNITED GAS PIPE LINE COMPANY**

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QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission has the authority to grant individual relief by permitting natural gas producers to reflect in their rates for sales of gas to pipelines incremental costs reflecting royalties actually incurred.
2. Whether, having refused to grant the individual rate relief requested, the Federal Energy Regulatory Commission erred in holding that the present or future public convenience or necessity did not permit abandonment of the royalty portion of the gas sold in interstate commerce.

STATEMENT OF THE CASE

Pennzoil Producing Company (Pennzoil) and Shell Oil Company (Shell) sell natural gas produced from the Gibson Field, Terrebonne Parish, Louisiana, to United Gas Pipe Line Company (United). A portion of the gas sold to United is produced from acreage covered by leases from Williams, Inc. *et al.* (Williams). The prices Pennzoil and Shell are permitted to collect from United for the sale of the gas are subject to the jurisdiction of the Federal Energy Regulatory Commission (Commission) under the Natural Gas Act, 15 U.S.C. § 717 *et seq.*, and to the applicable just and reasonable rates established by the Commission. Williams, however, has claimed that under its leases it is entitled to the payment of royalties on the basis of the market value of the gas rather than on the basis of the regulated price.¹ As a result of this claim, Pennzoil and Shell asked a Louisiana state court to declare that Pennzoil and Shell were paying correct royalties (A. 75-99).² By reconventional demand Williams asked the state court to declare the leases terminated, to assess damages for the alleged underpayment of royalties, and, in the event the leases were not terminated, to declare that future royalties must be based on prices alleged by Williams to be the market value (A. 116-117).

Subsequently, Pennzoil, Shell and Williams entered into a settlement agreement (A. 15-25). Among other pro-

1. *Texas Oil and Gas Corp. v. Vela*, 429 S.W.2d 866 (Tex. 1968); *Lightcap v. Mobil Oil Corp.*, 562 P.2d 1, *cert. denied*, 434 U.S. 876, petition for rehearing pending.

2. *Shell Oil Co. and Pennzoil Producing Co. v. Williams Inc., et al.*, Civil District Court for Orleans Parish, Louisiana, Docket No. 573-591 (filed May 24, 1974).

visions of this agreement, which if implemented would resolve the pending market value royalty litigation, Pennzoil and Shell agreed to seek Commission authorization to collect increased rates from United or, in the alternative, in the event that Commission authorization for the increased rates is denied, to seek authorization to abandon the sale of the royalty portion of the gas to United. The increased rates requested would reflect increased royalty costs, based upon the agreed upon rates set forth in the settlement agreement (A. 17-20), which are substantially less than those demanded by Williams as market value (A. 43, 66-67). The entire amount of the increase received from United would pass directly to Williams, and neither Pennzoil nor Shell would keep any amount of the incremental royalty increase.

Pursuant to the terms of the settlement agreement, Pennzoil and Shell sought Commission authorization to collect increased rates from United which would reflect the increase in royalty costs as provided for in the settlement agreement, or, alternatively, in the event the Commission denied the requested increases, Pennzoil and Shell sought Commission authorization to abandon the sale of the royalty portion of the gas to United (A. 2-6, 7-31). United sought leave to intervene in these proceedings, which was granted by Order of the Commission issued on September 22, 1975 (A. 39).

United intervened in the Commission proceedings on the basis of letter agreements it had executed with Pennzoil and Shell in which United agreed, subject to Commission approval, to pay the increased rates, or, alternatively, to release the royalty portion of the gas from its gas purchase contracts (A. 122-125, 126-129). United executed these agreements after being advised

of the pending market value royalty litigation, its possible adverse results, and that in an effort to settle the litigation, Pennzoil and Shell had entered into the settlement agreement with Williams. United took the position that it preferred Commission approval of the increased rate alternative, it being understood that the increases would be reflected in United's jurisdictional rates (A. 197). Commission approval of this alternative would ensure that all of the gas attributable to the Williams' acreage would remain available to United and its customers. However, if the rate alternative were denied, United then supported Commission approval of the abandonment alternative. Commission approval of the abandonment of the royalty portion of the gas would be preferable to the risk of lease cancellation and possible loss of all the gas to the interstate market and would at least keep the working interest portion available to United.

The Commission denied Pennzoil's and Shell's requests for increased rates by holding that it did not have the authority to allow producers increased rates based upon increased royalty costs calculated on a rate in excess of the Commission's just and reasonable rates. Citing this Court's decision in *Federal Power Commission v. Texaco*, 417 U.S. 380 (1974), the Commission stated (A. 261):

Accordingly, we believe that we are not free to allow royalty costs, which are based on market values, to be passed on to the pipelines as just and reasonable rates.

In denying the requests for abandonment authorization, the Commission held that neither of the two conditions for abandonment under Section 7(b) of the Natural Gas Act, 15 U.S.C. § 717f(b), had been met. The Commission

found first, that the supply of gas had not been depleted and second, that the present or future public convenience or necessity did not require that abandonment be authorized. The Commission relied upon its Opinion No. 737,³ for its determination that even if the litigation with Williams were lost and Pennzoil's and Shell's leases were terminated, the gas would remain committed to the interstate market.

On appeal, the United States Court of Appeals for the Fifth Circuit reversed the Commission. The Fifth Circuit held that the Commission erred in failing to realize it had the authority to permit rate relief, as this Court previously had held in *Mobil Oil Corp. v. Federal Power Commission*, 417 U.S. 283 (1974), and remanded the rate relief issue for a determination as to whether the relief requested should be granted. The Fifth Circuit stated:

Petitioners followed the proper procedures in petitioning the Commission for special relief and were entitled to a determination of the merits of their requests. In *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 94 S.Ct. 2328, 41 L.Ed.2d 72 (1974), *aff'g* *Placid Oil Co. v. FPC*, 483 F.2d 880 (5th Cir. 1973), decided the same day as *Texaco*, the Supreme Court, in response to Mobil's complaint that the FPC failed to provide automatic adjustments in area rates to compensate for anticipated higher royalty costs, reiterated the Court of Appeals' finding that "(i)f, as subsequent events develop, the producers are put in a bind by their royalty obligations, they may certainly petition FPC for individual relief." 417 U.S. at 328, 94 S.Ct. at 2355. Pennzoil and Shell

3. *El Paso Natural Gas Co.*, Opinion No. 737, Docket No. CP75-209 (July 11, 1975), *reh'g denied*, Opinion No. 737-A (September 3, 1975).

have been put in such a bind. If they lose the state court litigation, they are faced either with termination of their leases, which could divert the entire amount of gas from interstate commerce, or with increased royalty payments, which would absorb funds otherwise available for exploration and development. 553 F.2d at 488-9.

Further, the Fifth Circuit reversed and remanded for further consideration the Commission's rejection of the abandonment alternative. Relying on its decision in *Southland Royalty Co. v. Federal Power Commission*, 543 F.2d 1134 (5th Cir. 1976),⁴ the Fifth Circuit held that in denying the abandonment requests, the Commission had acted under the wrong legal premise in assuming that the gas would remain committed to the interstate market if the leases were cancelled as a result of the state court litigation.

A petition for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit was filed by the Commission and an order granting certiorari was entered by this Court on June 12, 1978 (A. 303).

SUMMARY OF ARGUMENT

A. The royalty owner under the Pennzoil and Shell leases filed suit to cancel the leases for the failure to pay royalties on the basis of the market value of the gas produced, and the parties entered into a settlement agreement providing for the payment of royalties based upon an agreed rate which is more than the Commission regulated rate and less than the market value. Pennzoil and

4. Subsequently reversed by this Court in *California v. Southland Royalty Co.*, 98 S.Ct. 1955 (1978).

Shell have been placed in the "bind" foreseen in *Placid Oil Co. v. Federal Power Commission*, 483 F.2d 880 (5th Cir. 1973) and have sought individualized relief as authorized by the Fifth Circuit in *Placid* and this Court in *Mobil*. However, the Commission has ruled that it does not have the authority to grant individualized relief for excess royalties, regardless of what showing a producer may make, and, therefore, that this Court did a useless thing in *Mobil* by holding that a producer may seek individualized relief for royalty costs actually incurred.

Placid and *Mobil* specifically authorize gas producers to seek individualized relief for royalty costs actually incurred and authorize the Commission to grant the relief upon a proper showing. This holding is fundamental to cost-based regulation. The regulated entity is entitled to have the opportunity to recover its actual costs, plus a fair rate of return. When the regulation is based upon industrywide average costs, as Commission regulation is based, there must be an opportunity to seek individualized relief. The Commission recognizes this principle, and its Regulations and Statement of General Policy specifically authorize a producer to seek individualized relief for costs actually incurred. However, the Commission argues that this Court's opinion in *Texaco* holds that royalty costs are the sole exception to this fundamental principle and that the Commission has no authority to grant special relief for royalty costs actually incurred, regardless of the showing made by the producers. The Commission argues that the estimate of industrywide average royalty costs must be included in the producer rate, just as the estimate of industrywide average successful well costs must be included in the producer rate. However, the

Commission argues that it may grant individualized relief for successful well costs actually incurred but that *Texaco* holds that it may not grant individualized relief for royalty costs actually incurred.

The Commission misreads *Texaco*. In *Texaco*, this Court held that the Commission may not equate the market value of gas and the just and reasonable rate for gas. This Court held that the market value is not *ipso facto* the just and reasonable rate. However, *Texaco* specifically holds that the market value may be considered in determining the just and reasonable rate. If market value may be considered in determining the overall just and reasonable rate, *a fortiori* market value may be considered in granting relief for costs actually incurred.

The authority to grant individualized relief will not result in loss of Commission control of rates nor cause an administrative burden. The Commission presently considers requests for individualized relief for costs incurred, other than royalty costs, and grants some requests and denies some requests. Requests for individualized rate relief for royalty costs incurred are no different in principle.

B. The Commission held that the present or future public convenience and necessity does not authorize the granting of abandonment of the royalty share of the gas for the sole reason that the gas would remain dedicated to interstate commerce under the holding of *California v. Southland Royalty Company* even if the leases are cancelled for failure to pay proper royalties. *Southland Royalty* is still before this Court. Moreover, whether the gas would remain dedicated to interstate commerce is not the sole consideration. For example, the Commis-

sion must consider if it is in the public convenience and necessity for the leases to remain under the management of experienced operators who have the capital resources to maintain the leases, or whether the public convenience and necessity permits the leases to revert to the mineral owner when it has not been shown whether the mineral owner could operate the leases efficiently and whether the mineral owner has sufficient capital to maintain the leases.

ARGUMENT

I.

THE COMMISSION HAS AUTHORITY TO GRANT INDIVIDUALIZED RELIEF TO NATURAL GAS PRODUCERS FOR ROYALTIES ACTUALLY INCURRED.

1. This Court's opinion in *Mobil Oil Corporation v. Federal Power Commission* expressly authorized the granting of relief from royalty obligations based upon a price higher than the regulated rate.

The Commission has posed the question whether the Commission has authority to grant to natural gas producers individualized rate relief for royalty costs actually incurred when those costs are based on the unregulated market price of natural gas.⁵ The question was answered

5. The question presented in this proceeding is not whether the producers have made a proper showing for entitlement to individualized relief; the question presented is whether the Commission has the authority to grant individualized relief to natural gas producers for royalties actually incurred when a proper showing has been made. The Fifth Circuit Court of Appeals correctly held that the Commission does have this authority and remanded the cause for determination by the Commission on the merits.

in the negative by the Commission in its opinion in this proceeding, but this question has been answered in the affirmative by the Court of Appeals for the Fifth Circuit in this proceeding and in *Placid Oil Co. v. Federal Power Commission*, *supra*, and by this Court in *Mobil Oil Corp. v. Federal Power Commission*, *supra*, affirming *Placid*.

In the Southern Louisiana Area Rate Proceeding, Mobil Oil Corporation foresaw that producers would incur royalty costs based on the unregulated price of natural gas and asked the Commission to provide an adjustment in its Opinion No. 598, which established area rates for Southern Louisiana.

In *Placid*, the Fifth Circuit reviewed and upheld the Commission's Opinion No. 598, and, in response to Mobil Oils complaint that the Commission failed to provide for an adjustment in area rates to compensate for anticipated higher market value royalty costs, the Fifth Circuit stated:

If, as subsequent events develop, the producers are put in a bind by their royalty obligations, they may certainly petition the FPC for individualized relief. *Permian* contemplated it. 483 F.2d at 911.

Placid was affirmed by this Court *sub nom. Mobil Oil Corp. v. Federal Power Commission*, *supra*, in which this Court expressed complete agreement with the Fifth Circuit:

Mobil argues that . . . the 1971 rate schedules must take into account the possibility of higher royalty obligations. We agree with the Court of Appeals that Mobil's argument is hypothetical at this stage

and that in any event an affected producer is entitled to seek individualized relief. 417 U.S. at 328.

Mobil Oil's argument was "hypothetical" as to royalties paid on rates in excess of the ceiling rate only because Mobil Oil was not then faced with the payment of such a royalty. As Mobil Oil stated to the Fifth Circuit:

* * * Royalty payments will exceed the levels used in arriving at costs to fix rates, and realization to producers will be reduced to the extent that royalty payments exceed those assumed by the Commission and are based on "current market value" in Southern Louisiana as determined from time to time for the periods covered by the Commission's area rate orders.⁶

Since the royalty payments "will exceed", rather than "had exceeded", the Fifth Circuit and this Court stated that the argument is hypothetical but that when the hypothetical problem becomes a reality, "an affected producer is entitled to seek individualized relief". The very question raised by Mobil Oil is no longer hypothetical. It is a reality, and the affected producers have sought individualized relief.

However, the Commission ignores that this is the very problem foreseen by Mobil Oil and argues that, while an affected producer may seek relief, the Commission may not grant relief. This emasculates this Court's *Mobil* opinion. It is idle to seek individualized relief when the Commission has no authority to grant the relief. The Commission seeks to avoid the appearance of robbing

6. Brief for Petitioner at 69, *Placid Oil Company v. Federal Power Commission*, 483 F.2d 810 (5th Cir. 1973).

Mobil of its clear meaning by arguing that this Court did not say in what circumstances the Commission may grant relief. The brief filed by Mobil Oil in that proceeding makes clear that Mobil Oil was talking about the precise "hypothetical" problem that is now a reality and that this Court was addressing that precise "hypothetical" problem when it stated that "an affected producer is entitled to seek individualized relief". In its brief to this Court, Mobil Oil stated:

* * * The Commission . . . refused to include in its rate structure a clause providing for adjustment of the base area rates where producers . . . are required to pay royalties on the basis of "market value" or other bases higher than producer rates prescribed by the Commission.

* * *

In the more recent Commission Docket No. AR-70-1, Mobil demonstrated that far more than a "hypothetical" problem now exists. There, Mobil advised that the State of Texas has filed an Original Petition in the District Court of Travis County, Texas, 53rd Judicial District against Mobil, claiming that the State of Texas,

" . . . is entitled to receive the 'Market Price' for its royalty at the time of the sale."

and

" . . . that the State of Texas, as a royalty owner is not limited to any regulated ceiling prices as promulgated by the Federal Power Commission. . . ."

The Commission has been advised that other efforts to obtain such royalty payments are being made, and that producers' revenues in all areas are simi-

larly threatened. However, the Commission errs in ignoring that producers are now facing such claims for payment of royalty on "market values" which are substantially above the Commission-prescribed producer area rate ceilings.⁷

The Fifth Circuit correctly noted in its opinion below that the claim for higher royalties and the state court litigation have put Pennzoil and Shell in the bind mentioned in *Placid*, 553 F.2d at 488, that the Commission erred when it "failed to realize it had the authority to grant relief", 553 F.2d at 486, and correctly held that "Petitioners followed the proper procedures in petitioning the Commission for special relief and were entitled to a determination of the merits of their requests." 553 F.2d at 488.

2. This Court's opinion in *Federal Power Commission v. Texaco, Inc.* is consistent with *Mobil*.

The Commission recognizes that *Mobil* specifically authorizes an affected producer to seek individualized relief for royalty obligations based upon the unregulated market value, but argues that *Federal Power Commission v. Texaco Inc.*, 417 U.S. 380 (1974), denies it authority to grant individualized relief for royalty costs higher than those provided for in the regulated rate.⁸ In effect, the Commission finds *Mobil* and *Texaco* to be inconsistent and gives controlling weight to *Texaco*.

7. Brief for Petitioner at 81-83, *Mobil Oil Corporation v. Federal Power Commission*, 417 U.S. 283 (1974).

8. The settlement rate in this proceeding is less than the market value, but the Commission equated the two by stating that it may not grant individualized relief "for additional royalty payments which are based on other factors than the regulated rate" (A. 260).

Texaco was handed down by this Court on the same day that this Court affirmed *Placid* in *Mobil*. This Court obviously saw no conflict between *Texaco* and *Mobil*, and no conflict exists.

In *Texaco*, this Court reviewed the Commission's Order No. 428 dealing with the regulation of "small producer" sales. This Court held Order No. 428 to be invalid because of its use of the market price as the *sole* determinant of the just and reasonable small producer rate, thereby equating the market price and the just and reasonable rate, or, as this Court stated, ". . . the prevailing price in the marketplace cannot be the final measure of 'just and reasonable' rates mandated by the Act." 417 U.S. at 397. The Court found Order No. 428 to exempt small producer rates from regulation.

Sections 4 and 5 of the Act require that all gas rates be just and reasonable; and the Court held in *Phillips* that this very prescription applies to the rates of all gas producers. The Commission may have great discretion as to how to insure just and reasonable rates, but it is plain enough to us that the Act does not empower it to exempt small-producer rates from compliance with that standard. 417 U.S. at 394.

Texaco proscribes the use of the unregulated market price as the *sole* standard for determining the just and reasonable rate, but it does not proscribe the use of the unregulated market price as one element to be considered in determining the just and reasonable rate. On the contrary, this Court expressly stated in *Texaco* that it did not "mean that the market price of gas would never, in an individual case, coincide with just and reasonable rates or not be a relevant consideration in the setting of area rates . . . ; it may certainly be taken into account . . ."

417 U.S. at 399. If the unregulated market price may be taken into account in setting the area rate itself, *a fortiori* it may be taken into account in granting individualized relief from the area rate. If the unregulated market price may be taken into account in setting the area rate itself, *a fortiori* it may be taken into account in granting individualized relief for a single component of the area rate.

3. The higher royalty obligation is an actual cost, and individualized relief may be granted for higher costs.

The Commission has adopted a cost-based regulation and bases its just and reasonable rates upon estimated industrywide average costs. This methodology was applied to a geographical area of the nation and approved by this Court in *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968). The establishment of a national rate by this methodology was approved in *Shell Oil Company v. Federal Power Commission*, 520 F.2d 1061 (5th Cir. 1975), cert. denied, 426 U.S. 941 (1976). In *Shell*, the Fifth Circuit noted that the overall cost determination was based upon an evaluation of thirteen individual cost components, including such components as Successful Well Cost, Lease Acquisition Cost, Cost of Other Production Facilities, and Royalty Expense. Each component is intended to be the estimated actual cost of that component. For example, the estimated Successful Well Cost is determined by reference to the actual market cost of drilling and equipping a successful well, and Lease Acquisition Cost is determined by reference to the actual market cost of leases bought from private landowners and governmental entities, including the Department of

the Interior. The determination is intended to take into account actual costs.

As noted in *Shell*, Royalty Expense is one of the cost components of an area rate or nationwide rate. In the overall cost determination:

Royalty Expense represents the percentage of the gross receipts which a producer must pay to the landowner for the privilege of extracting from the reserves underlying his land. It was computed by applying a percentage to the gross receipts. 520 F.2d at 1068.

In "applying a percentage to the gross receipts", the Commission treated the regulated rate itself as being the gross receipts and applied a percentage to the regulated rate to determine the actual cost of Royalty Expense.

Some leases do provide for a landowner's royalty of a "percentage of the gross receipts", and the actual cost of the Royalty Expense of these leases is considered in the area rate or nationwide rate. However, some leases provide for a percentage of the market value of the gas, even though the market value exceeds the gross receipts from the sale of the gas, and for those leases the royalty paid is a percentage of the market value, not a percentage of the gross receipts. Since the Royalty Expense in an area or national rate determination is computed "by applying a percentage to the gross receipts" instead of by applying a percentage to the market value, the actual royalty cost in market value leases exceeds the Royalty Expense allowed in the area or national rate. This is the exact fact situation foreseen by Mobil Oil in *Placid* and *Mobil*.

It is fundamental to cost-based regulation that the regulated entity must be permitted the opportunity to recover its costs incurred, plus a fair rate of return. Where the regulation is based upon industrywide average costs, there must be an opportunity for individualized relief for actual costs incurred.

The Commission has provided for individualized relief in Section 154.105(j) of its Regulations and Sections 2.56a and 2.56b of its Statement of General Policy and Interpretations Under the Natural Gas Act (18 C.F.R. § 154.105(j) and 18 C.F.R. § 2.56a and 2.56b). The Commission has granted relief for such costs as compression and remedial well work, even though these costs are determined by an uncontrolled market, and the Fifth Circuit correctly noted that "the Commission has failed to suggest why royalty costs in an uncontrolled market are any different from any other cost." 553 F.2d at 488.

4. The authority to grant individualized relief is consistent with Commission regulation.

The Commission argues that the authority to grant individualized relief to Pennzoil and Shell is contrary to basic principles of regulation. The Commission is in error. The authority to grant individualized relief is consistent with the principles of regulation and is consistent with Commission precedent. The Commission does grant individualized relief based upon costs actually incurred and has done so for years.

The Commission argues that:

- a. While the Commission may grant individualized relief, ". . . it is not required to do so merely

because the producer's own costs exceed the area or national average." Brief, p. 18.

No one here argues that the Commission is required to grant the relief requested. That question is not presented. The sole issue in this proceeding is whether the Commission has the authority to grant the relief requested.

- b. "... The fact that one or even all producers incur a particular cost does not require the Commission to include all of that cost in the rate base if it is excessive or unreasonable." Brief, p. 18.

No one here argues that the Commission is required to grant the relief requested. The Commission has not made a finding that the cost to be incurred is excessive or unreasonable. The only determination that the Commission has made is that it has no authority to grant the relief requested, and the question of authority is the sole question before the Court.

- c. The Commission may refuse to establish rates that reflect contract clauses providing for indefinite price escalations. Brief, p. 19.

No one here questions this statement. No contract clauses providing for indefinite price escalations are involved in this proceeding.

- d. The Commission may not establish rates on the basis of the unregulated market price of natural gas. Brief, p. 19.

The Commission's statement is a correct reading of *Texaco*. The Commission may not equate the

unregulated market price per Mcf of gas for the per Mcf regulated rate, and that is not what the Commission is being asked to do. The Commission is being asked to grant relief for a *cost* actually incurred. The Commission has granted special relief for such costs as drilling costs and workover costs. The cost of royalty is no less a component of the producer's cost than is the cost of drilling.

- e. If the Commission permitted a rate increase for the increased royalty, jurisdictional rates would be subject to unpredictable fluctuations and escalations beyond the control of the Commission. Brief, p. 21.

This is a phantom that experience has shown does not exist. No one here argues that relief is automatic. If it were, there would be no necessity to request the relief. The Commission has granted individual relief for years, and there have not been unpredictable fluctuations and escalations beyond the Commission's control. The Commission has considered each request on an individual basis—it has exercised control on an individual basis—and that is all the Commission is asked to do in this proceeding. Nothing is automatic. Nothing is uncontrolled.

- f. The Court of Appeals decision would compel the Commission to permit royalty cost pass-throughs in many, if not in most, cases. Brief, p. 23.

The Court of Appeals decision would not compel the Commission to do anything except to decide

the merits of the request for relief by Pennzoil and Shell. The Commission has the authority to grant individualized relief for costs incurred by producers and over the years has granted some requests and denied some requests, but the Commission has never before argued the *non sequitur* that the authority to consider the requests compels the granting of the requests. No one makes that argument here.

II.

THE ISSUE OF ABANDONMENT OF THE ROYALTY PORTION OF THE GAS SHOULD BE REMANDED TO THE COMMISSION FOR FULL CONSIDERATION ON THE MERITS.

As an alternative to their request for rate relief, Pennzoil and Shell sought abandonment of the royalty portion of the gas. As the rate alternative was denied, abandonment of the royalty portion of the gas became preferable in light of the consequences if the state court litigation were lost. Commission approval of the abandonment alternative would ensure that the working interest portion of the gas remain available to United.

Under Section 7(b) of the Natural Gas Act, 15 U.S.C. § 717f(b), abandonment can be granted on a showing that the available supply of gas is depleted to the extent that the continuation of service is unwarranted or that the present or future public convenience or necessity permit such abandonment. There was no evidence here of depletion of supply, therefore the question was whether

the present or future public convenience or necessity permits such abandonment.

United argued that in this time of a severe gas supply shortage in the interstate market, the Commission must find that it is in the public interest to retain as much gas as is available to the interstate market; that approval of the abandonment alternative would eliminate the risks of the litigation and possible lease cancellation and would at least insure the retention of the working interest portion to the interstate market; and that abandonment is permitted by the statutory test of the present or future public convenience or necessity.

The Commission held that the present or future public convenience or necessity does not permit approval of the abandonment alternative. In responding to United's argument the Commission stated:

... once the gas is dedicated, we do not share the concern of Pennzoil and United that Williams could terminate deliveries to United even if the leases were cancelled as a result of state court litigation. If the lease were cancelled and Williams were to undertake to sell the subject gas, Williams would simply assume the obligations of Pennzoil and Shell to continue service to United. (A. 262).

The Commission was relying on its Opinion No. 737.

The Fifth Circuit, subsequently reversed Opinion No. 737 in *Southland Royalty Co. v. Federal Power Commission*, *supra*, and in light of its decision, remanded the abandonment issue to the Commission for reconsideration. The Fifth Circuit held that the Commission was acting under the wrong legal premise in that "the Com-

mission was under the impression that Williams' gas was trapped in the interstate market, whether or not the leases were terminated" (Pet. App. 9a).

This Court has recently reversed the Fifth Circuit's decision in *California v. Southland Royalty Co.*, 98 S.Ct. 1955 (1978), and upheld the Commission's Opinion No. 737. In its Brief, the Commission states that by the principles enunciated in *Southland Royalty Williams* would be obligated to continue the interstate service initiated by Pennzoil and Shell to United, even if the leases were cancelled by the state court litigation. The Commission concludes that the Fifth Circuit's holding on the abandonment issue should be reversed and the Commission's determination affirmed.

It is United's contention that the abandonment issue should be remanded to the Commission for reconsideration to determine whether the public convenience or necessity would permit abandonment of the royalty portion, if the rate relief alternative is denied. First, *California v. Southland Royalty Co.*, is currently pending on rehearing before this Court. Secondly, if the state court litigation were lost and the leases cancelled but under the principles enunciated in *Southland Royalty Williams* was compelled to continue interstate service to United, United would still have concerns. The continuation of deliveries in interstate commerce is not the sole consideration. For example, it is not shown that Williams has experience as a producer of natural gas or the capital necessary for additional work on the leases as was projected by Pennzoil and Shell to bring forth additional supply, if the settlement agreement was approved (A. 47-48, 67).

CONCLUSION

For the reasons stated in this brief, United requests this Court to affirm the judgment of the Fifth Circuit and to remand to the Commission for further proceedings to consider the merits of Pennzoil's and Shell's application.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have served three copies of Brief of Respondent United Gas Pipe Line Company on counsel of record for the other parties by depositing copies of it in the United States Mail, postage prepaid on October 4, 1978.

DONALD R. ARNETT